RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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Dec. 2 DJIA 2092.28; PTI 2801; A-D Ratio -12.62
Dec. 9 DJIA 2143.49; PTI 2822; A-D Ratio -12.32
Current Dow Yield: 3.71%; Dow P/E: 11.8
Dow 200-day MA: 2075; DowPow: 652
Percentage of undervalued blue-chips: 22%

No Joke: Ponder this one: sophisticated observers are saying that "Reagan's greatest legacy to the nation" could be his huge deficits. Why? Those deficits will prevent Democrats from enacting the massive new spending programs that they have been itching for. Instead, the poor Dems will be forced to "try to" cut spending, a situation they've never been faced with before.

THE PICTURE: I am looking at a report written on December 3, 1954 by the great Dow Theorist, George Schaefer. In this report Schaefer states: "*If I had to say where most people go astray in the stock market, I would say that is is probably due to their giving too much attention to individual stocks and too little attention to the primary trend of the market. In my opinion, a correct diagnosis of the primary trend is the most important factor leading to success in the market.*"

Schaefer was referring to the giant bull market that was then in force. Schaefer had turned bullish back on June 13, 1949 (at the exact bottom of the bear market -- to the day), and he was urging his subscribers to remain fully invested in stocks as the bull market progressed. "*Forget trying to trade the market,*" Schaefer urged his subscribers, forget trying to pick the ultimate winners. Buy a diversified list of blue-chip stocks and "*ride the bull trend to the top.*" This was exactly what Schaefer did, staying fully invested in the bull market until 1966, at which point that fabulous bull market topped out.

All right, now let's apply this thinking to the present. But since the tide has turned down, we must deal with the other side of the coin. A primary bear market began in August 1987. My subscribers and I have been out of this market ever since the summer of 1987. In doing so, we avoided history's greatest crash, said goodbye to the great bull market, and put our money in bonds and money instruments

Thirteen months have gone by since the Great Crash. As this is written, the Dow is still 570 points under its 1987 bull market high and the advance-decline ratio (a proxy for the entire NYSE) is within one point of its lowest level of the entire bear market, and I'm referring to the December 1987 low.

"But some people have made money since the crash," I am told. "And many stocks have rallied to well above their 1987 crash lows." And my answer is, "So what. We've made money in bonds, and we've enjoyed very attractive returns on money market instruments." And this is crucially important, at least it is for me -- we've never lost an hour's sleep over the crash or the erratic stock market. We've kept our sense of calm ever since we sold out in mid-1987.

Now believe me, peace, a feeling of equanimity, is very important in this life. Over the past year three of my best friends have died, and in each case I believe I can trace at least part of the reason for their deaths to stress. One of the things I've learned in my 64 years on this earth is that stress is the great killer. Stress is the mental equivalent of two frantic horses each pulling a harness in opposite directions. Experts in the field now believe that stress is a major factor in approximately 60% of the world's diseases (dis-ease, an absence of ease).

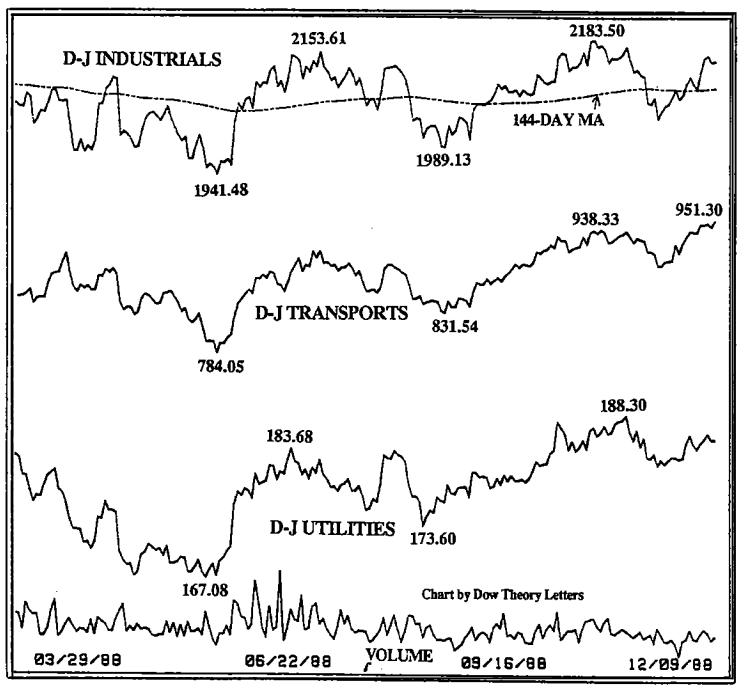
While I am on the subject, I might as tell you a little more of what I have learned in this area. First, there is a big difference between tension and stress. A certain amount of tension is present in all life. Life cannot exist without healthy tension. Tension is what we feel before a big football game. Tension is the excitement we experience when we meet someone who is important to us. Tension is what we feel when we see a great movie. There's nothing wrong with a healthy amount of tension. It shows that we're alive and confronting life.

Stress is a different animal. Stress is always a result of conflict. The conflict can be conscious or unconscious. Here are examples of items that produce conflict and stress. Should I be honest about this transaction or should I lie and make a big profit? Should I stay married or should I face the pain of divorce? Should I stay on this safe job or should I accept a very risky, higher-paying job? Should I hold stocks in this bear market even though I feel queasy about it or should I stay out and maybe miss a big move on the upside?

The above questions are all about conflict. And make note of this -- unresolved conflict always, ALWAYS, produces stress.

In the stock market I know of only one way of avoiding the killer, stress. That way is to follow a correct, time-tested procedure. Following correct procedure implies study and knowledge. It is the opposite of willy-nilly investing based on how you feel today or what your hot-shot neighbor told you about some "sure-to-happen merger."

That, in a nutshell, is why I write the way I do and why I invest the way I do. Sure the market (as detailed in the last Letter) was becoming oversold. Sure the bonds are acting well. Sure the market is entitled to a year-end rally. But correct procedure tells us



to be conservative and careful, because this is a bear market, and the bear is a treacherous animal. Bear markets beckon us to "come back in," to "climb aboard." Bear markets can taste as sweet as cane sugar and smell as irresistible as Elizabeth Taylor's new perfume. But the bear has one purpose in mind, and that is to lure investors and traders back to the fold -- and then to decline, taking the greatest number of stockholders with him.

Can you beat the bear? Sure you can beat him. You can beat him -- for a while. But keep playing games with the bear, continue to taunt the bear, and sooner or later he will clasp you in his grip. When that happens, profits evaporate, and you'll be left with painful losses. If your mode of operation is to buy in a bear market, to trade the bear market, to hold "the strongest stocks" even during a bear market, then I can tell you that you're on the road to patched pants and a thin wallet.

In the last Letter I outlined some of the technical pluses in this market -- the fact that the PTI has not yet broken down, the fact that the major averages have not confirmed the weakness in the advance-decline ratio, the fact that breadth has been declining for nine months, the fact that the public is market-shy and doesn't trust this market.

I also said that the market was semi-oversold, and that it would take more selling or even a final wipe-out to provide the market with a really solid base -- a base capable of supporting a broad, powerful rally.

But bear markets are tedious and the bulls grow impatient. The rally, unfortunately, did not start from a fully oversold base. The rally began from the November 16 low, and the advance carried the Dow above the 2100 level for the upteenth time this year. But note that the breadth was poor on the rally, and on no single up-day did we see as many as 1,000 advances.

We did see an important non-confirmation, however. On December 5 the D-J Transportation Average rallied to close above its October 25 post-crash high of 938.33. The Industrials followed in direction, but as this is written they have still not confirmed (the peak that the Dow must better in order to confirm is 2183.50, recorded on October 21). Thus, we now have a major upside non-confirmation. A downturn from here (because of the non-confirmation) could be dangerous.

A few words about DowPow, my proprietary index of the Dow adjusted for market breadth. DowPow has gone nowhere since the '87 crash. The extreme low for DowPow was 519.34 recorded on December 4, 1987. Following that bear market low, DowPow got as high as 1186.13 -- recorded on March 3, 1988. Since then DowPow has traced out a series of declining tops. As this is written DowPow is not far from its December 1987 low. The reason for Dowpow's poor performance, of course, is the lagging performance of breadth since the crash.

My other proprietary index, the PTI (Primary Trend Index), however, has steadfastly said that this market is not ready to roll over and die. The PTI has been walking steadily up its 89-day moving average, and as long as this condition remains, the market will either climb or hold its own. I consider the PTI one of the premier weapon for the intrepid trader.

Conclusion: This whole post-crash period is one of the most unusual in stock market annals. If I were pressed to say what it means, I would say this: The post-crash trading range in the market is Wall Street's way of playing "the waiting game." But what is the market waiting for? It's waiting for trouble -- in the form of a dollar crisis, an interest rate squeeze, a business recession or all three.

The post-crash waiting period has now lasted almost 14 months. But the market is in no hurry. And meanwhile, with downside pressure finally subsiding, the market is celebrating (1) the year-end rallying tendency (2) continuing good business, (3) the fact that the price structure of the averages has held together despite miserable breadth, (4) the strong bond market, (5) glasnost, perestroika, and Mr. Gorbachev..

Finally, although I'm not sure you can call this a reason for celebrating, there are four (count 'em) bona-fide MANIAS going on in the world today: (1) the US debt and deficit mania; (2) the LBO and corporate takeover mania; (3) the Japanese no-yield stock market mania, and (4) the art market mania. Believe me, the auction market for art is a mania.

Market Notes: My good friend, Robert Prechter (of Elliott Wave fame), starts his latest (Nov. 28) report as follows: "October 1987 went down in history as one of the stock market's most dramatic months. October 1988, I suspect, will go down in history as one of its most important months, since it is likely to stand as the high of the post-crash rally, mark the end of the economic expansion which began in 1982, and kick off the next Great Depression and the Nightmare Nineties. Like the full significance of October 1987, that of October 1988 will not generally be perceived for many months, perhaps years."

The December *Bank Credit Analyst* starts as follows: "Short term rates will rise further. The decline in the trade deficit is stalling and the pace of economic growth is too rapid. The risk of a credit crunch is increasing. The Fed will not be able to ease until dollar confidence is restored and inflation expectations fall . . . . The environment for stocks is gradually deteriorating. . . . High quality bonds are favored over stocks. Any signficant rise in yields would represent a buying opportunity."

* *

If you want to gauge the resistance on a day when the Dow rallies, add the number of issues declining and unchanged. If declining and unchanged outnumber the number of issues advancing, you're seeing real resistance to the advance. The same is true on a day when the Dow declines. If advancing and unchanged issues out-number those declining, that's strong resistance to the decline.

* *

I've been saying that despite what you hear, the public has never sold stocks in this market -- they've simply stopped buying. This is confirmed by statistics from *Dean Witter* Senior VP John Mendelson. John notes that as of Sept. 30, 1988 net redemptions of equity mutual funds for '88 were only $2.9 billion out of a total of roughly $191 billion in equity mutual funds. Thus in '88 the public has switched out of only 0.5% of its equity funds.

INVESTMENT POSITION: Yields on the 91-day T-bill are 8.25% (free of state taxes) vs. a taxable Dow yield of 3.75%. This means that bill yields are considerably better than twice the yield on the Dow. At the same time Barron's Highest-Grade Bonds show a yield spead of 5.73% in favor of AAA bonds over the Dow. Thus, financial instruments represent brutal competition for stocks, and I don't care how oversold the stock market is.

Two weeks ago (before the National Economic Commission) former Fed chief Paul Volcker said something I've been saying for two years. Volcker said, "As things stand we are hostage to the psychology of markets." In other words, Volcker is saying that the US doesn't run its own financial house any more. When you're the world's biggest debtor and you owe foreigners $40 billion you give up your freedom. So the money markets run this nation's finances, and Japan (which buys 30% of our federal debt) is increasingly becoming THE power in the money markets.

Which way will bonds go?" you might as well ask, "Whither Mr. Bush and Congress on the deficits? And will Japan accept it?" The election is over. The smoke has cleared, and Mr. Bush will never have more power than during his first few months in office. So if

Bush is going to move on the deficit, he'd better move fast and decisively.

The bear stays in the box, and subscribers (except for those trading strictly on the trend of the PTI) remain on the sidelines. Bonds are holding up fairly well, the precious metals are perking up, and the averages continue to bounce around in their trading range, while market breadth lags badly. Personally, I'm placing all my new money in cash funds or muni cash funds. The operative word for the present is --patience. After all, the stock market is playing "the waiting game," why can't we?

1990: The battle of greed and egos was heating up to unbelievable proportions. A Japanese consortium had just purchased IBM for $110 billion and was preparing a bid for GE. Not to be undone, Donald Trump announced an LBO of New York City, while at the same time (as a sweetener) he promised a massive revamping of the City's crumbling sewer system. Mitsubishi of Japan immediately retaliated by buying (for cash) the Capital building in DC along with the treasured Washington monument. This proved too much for Henry Kravis. KKR, with massive participation from 27 US pension funds, purchased 70 blocks of downtown Tokyo. (The amount paid was undisclosed.)

Not to be undone, an angry Japan, Inc. bought (totally for gold) the states of Delaware and Virginia. Here, the battle for global assets assumed white hot proportions. In a shocking move the Bass Bros. (with Pritzker's help) announced a hostile takeover of the Bank of Japan.

Threatened by the growing power of the capitalist nations, Russia's Gorbachev declared that the world's largest stock exchange would soon be opening in Moscow. (It was immediately rumored that Merrill Lynch and Shearson were vying for premier space on "the great red floor.") Further, Gorbachev stated that Russia would be making a hostile bid for the entire state of California and he further boasted that no power on earth could stop . . . . . (Editor's note: At this point my crystal ball grows cloudy.)

PRICE-BREADTH DIVERGENCE: I've been writing about divergence, the sagging breadth, and the resistant Dow, for many months (see page 2 chart). But what does it mean? What does it signify?

Like nature, the stock market loves harmony and hates a vacuum. The market likes all its sectors to move harmoniously together -- blue-chips, little chips, secondary stocks, industrials, transports, utilities. But occasionally, the market turns schizophrenic. When the 30 blue-chip Dow stocks part company with the rest of the market, such a situation signifies dis-harmony. On rare occasions, the dis-harmony becomes chronic. I term extended (three to four months or more) of price/breadth divergence as chronic stock market schizophrenia or a market aberration.

The market dislikes price/breadth divergences, and the market's usual reaction to such aberrations is to wipe out or retrace all or more of the action that produced the divergence.

In previous Letters I described four earlier periods of major (i.e., four months or more) price/breadth divergence. In each case the final result was a major correction or the onset of a primary bear market.

How about divergences following a market crash? There are only two previous instances in modern history where, following a crash or a collapse, the market produced a major price/breadth divergence (i.e., the divergence occurred within six months of a market collapse bottom).

Here are the two instances, and I believe they are worth reviewing (those who have the Dow Theory Letters Advance-Decline Ratio Chart Books should refer to these): (1) The Dow hit a high of 684.47 in January 1960. From there a violent decline took the Dow to a low of 566.05 in October 1960. The recovery from the October low began immediately and continued into 1961. But in March of '61 (five months after the low) the A-D ratio topped out -- although the Dow continued higher. This price/breadth divergence continued throughout the rest of 1961 and into '62. Despite the declining (diverging) A-D ratio, the Dow advanced to a March 1962 peak of 723.54. From there a second collapse took the Dow to a new low (in June 1962) of 535.76.

(2) The Dow advanced to a high of 950.82 in April 1971. A steep decline followed with the Dow dropping to a low of 797.97 in November 1971. From there the market rallied into 1972, but in March 1972 the A-D ratio topped out and headed lower. Despite the steady decline in the A-D ratio, the Dow continued to climb throughout the rest of 1972, finally hitting a high of 1051.70 in January 1973. From the January high the market entered the worst bear market since the 1930s, the bear market of 1973-74.

So there you have it: the only two instances where, following a market collapse or crash, a price/breadth divergence developed within six months of the collapse bottom. In 1960-61, the collapse was followed by a second major decline -- during 1962. The price/breadth divergence, occurring so soon after the collapse bottom, was the market's way of saying that there was more trouble to come -- and soon.

In 1971-72, the price/breadth divergence, coming so soon after the initial collapse, was again saying that there was more trouble on the way. The trouble was a vicious bear market that decimated stocks over a period of the next two years.

Today we have a third instance of an extended price/breadth divergence which appeared only five months after the crash bottom. What can we conclude from this? I believe that the appearance of an extended divergence only five months after the crash bottom is telling us that the stock market is still basically weak, that the technical structure of the market is askew, and that there's something in the future that the market (in it's collective wisdom) does not like.

I don't pretend to know how this bear market is going to unwind. I don't know how long it's going to last, how long the frustration is fated to go on, or how costly and painful this bear market is ultimately fated to be. But I do know this. We've had an unending stream of good business news since the crash, and during that period the bear market has produced one of the longest periods of price/breadth divergence in stock market history.

In the meantime, the good business environment has encouraged the bulls while the divergent market performance has heartened the bears. I'm convinced that we're in the early stages of a major bear market.

As I've said so many times before, this bear market will ultimately (at the bottom) provide us with great values in blue-chip stocks. Our job is to stay solvent (and hopefully to build liquid assets) until bargain time arrives. That's the way I'm playing it, and that's the way I've been writing it.

QUESTIONS and ANSWERS: Question: The Nov. 29 *Investor's Daily* headlined, "Great News: Experts Are Down on Stocks. Percent of Letter-Writers Now in Bearish Camp Hits a 5-Year High; Is Upturn Near?" Russell, what about this so-called percentage of bullish advisors? Is it valid and is it telling us something?

Answer: It all started when William Hamilton, in his landmark book, *"The Stock Market Barometer,"* made the famous statement that he had "never known the majority of professionals to be correct on the market." This phrase was widely quoted during the 1960s and '70s, and ultimately it led to a few investment services actually tabulating the opinion of leading advisory letter writers. Why use letter writers? Simple, because the writers have to put their opinions on the line -- in print. That makes them easy to tabulate.

All this gave rise to the now widely-followed study known as the "Percentage of Bullish Advisors" (and this is what *Investor's Daily* was referring to in its headline).

What do I think of the study? I think it's interesting, but I also feel that the study has attracted too much attention and that it is too widely quoted in newspapers, magazines, and on TV. The stock market has a way of dealing with widely-followed market studies -- it discounts them, and this is what I suspect may be happening with the Percentage of Bullish Advisors. In other words, I distrust it as a market tool.

There's something else. In a primary bear market it is normal for sentiment to turn increasingly bearish as the bear market progresses (just as it is normal for market sentiment to turn increasingly bullish during the course of a primary bull market). Thus, ever since the 1987 crash, market sentiment has been somewhat fearful, but this is to be expected. When the second phase of this bear market finally arrives (and it will arrive during or just prior to the next recession) expect sentiment to turn even more gloomy. Market pessimism will reach a crescendo during the third and final phase of the bear market (this is the "give up phase," the phase when stocks are sold for no other reason than investors need to raise cash). In that atmosphere, we can look for the end of the bear market, and the birth of the next primary bull market.

Question: Russell, it's been 15 months since the August 1987 peak in the bull market. And yet business is still good. How can this be a bear market when business is still humming 15 months after the top?

Answer: First, the Dow is still 580 points below its bull market high. Second, the advance-decline ratio (which is a proxy for the entire NYSE) topped out last March 17, and it has been declining ever since (it recently wiped out all its gains for 1988).

Nevertheless, people equate a bear market with an immediate downturn in business. It doesn't have to happen that way. From all corners we hear, "Hey, great, the crash didn't put a dent in the US economy." But as usual, the economists and investors are looking in the wrong direction at the wrong items at the wrong time. Believe me, we'll get all the trouble we want -- but it will take time.

This is what I want my subscribers to realize. The bear market which began in August 1987 and the subsequent market crash represented a watershed change in investors' perceptions. The primary bear market and crash reflected investors' dramatic reappraisal of the future value of American equities. The bear market and the crash were the stockmarket's way of saying that the best had been seen and that the overall climate for stocks had changed -- for the worse. That's what the bear market is about -- it's about the beginning of a major swing from enthusiasm and hope (at the 1987 top) to ultimate depression and gloom (which will materialize as this bear market finally moves into its bottom area).

At this point, it is admittedly difficult to see what could possibly occur to drive blue-chip stocks down to bargain levels, levels at which we might see the the Dow at a yield of 6%, 7%, or even more.

But when we realize the situation the US has put itself in, we might get a hint of things to come. For instance, never has a nation with a reserve currency owed so much. Never in modern history has the US been confronted with a situation in which it was a major international debtor. Never has the US been in a situation where it was dependent on foreigners to buy its continuing debt. Never in the post-War period has the US been faced with such vicious business competition, not only on a price basis but on the basis of technological innovation.

On November 30 the *New York Times* pubished a remarkable piece by Kenichi Ohmae, manager of McKinsey Securities' office in Tokyo. I include a few paragraphs from that piece below:

> TOKYO--Toshi Sato's 1,500-square-foot apartment in downtown Tokyo, which cost him a half-million dollars five years ago, has a market value today of $8 million. Earlier this year, Mr. Sato talked with a Tokyo bank, which offered to loan him $6 million. So off he flew to Southern California, where for $1 million, a small fraction of his lending limit, he bought a five-bedroom house on the waterfront.
>
> Half of the appreciation of Mr. Sato's Tokyo apartment is real, but the other half comes from the devaluation of the dollar. Indeed, the dollar-yen exchange rate, which has moved to 120 from 260 in the past several years, has declined to the point of making America a bargain basement.
>
> The question for Japanese investors is what to buy in the U.S. Japan is already the largest purchaser of American aircraft, scientific instruments and agricultural products. Dollars can't be used to buy from U.S. companies such as IBM, Texas Instruments and Xerox, which are well-established in Japan and sell their products for yen. Japan's first choice was to buy U.S. government securities, which helped finance the U.S. federal deficit. The interest rates on these securities were attractive, but the depreciation of the dollar burned Japan's fingers. So the focus shifted to more speculative investments with potentially higher risks and returns: real estate, stock and LBO funds.
>
> Some of America's most competitive "exports" today are land, houses and companies. But they are becoming too cheap. To realize how out of balance things are, consider this: If you collateralized a good-sized Tokyo office building, you could buy a $1 billion company in the U.S. In fact, the real-estate value of Tokyo at $7.7 trillion is so high that, once collateralized and borrowed against (at 80% of current value), it could buy all the land in the U.S. for $3.7 trillion, and all the companies on the New York Stock Exchange, NASDAQ and several other exchanges for $2.6 trillion.
>
> American concern about the trade deficit with Japan has created the false idea that the dollar must depreciate further for the U.S. to become competitive. If that happens, investment in the U.S. will increase. But if the U.S. wants to slow the pace of foreign investment, then it must keep up the value of the dollar.
>
> America must make a choice: Does it want to sell more goods or more real estate and companies?

Question: All my investments are denominated in dollars, and I'm very worried about the dollar. What should I do?

Answer: For the average investor the easiest way to hedge against a declining dollar is with gold. I've been recommending monthly fixed-dollar puchases of gold for the past two years. I've also recommended platinum, which recently has far outpaced gold.

Other ways of hedging against the dollar are with Japanese or German bonds, with a foreign bond fund, with a currency fund as mentioned in the last Letter, or with currency futures.

This is a very difficult area for most Americans since dealing in foreign currencies is something they have so little familiarity with. For a number of reasons, I continue to prefer gold coins. First, you

actually possess the gold which should be stored in your vault. Second, gold will do well in a crisis. Third, gold can rise against all paper currencies whether marks, yen, or francs. Aside from the gold hedge, my own feeling is that the average person will probably lose more money attempting to hedge against the dollar than the effort is worth.

NOTES and QUOTES: From all appearances, it looks like a long, bitter deadlock on the budget deficit, and it looks like the deadlock will last until next September (when the current fiscal year ends). Bush states that he will open negotiations with Congress on the first day of his new term, and he repeats -- "no new taxes." The Dem majority in Congress will not propose new taxes (which Bush would only veto) and will go along with taxes only if Bush initiates them and does not blame the Dems for the taxes. Without new taxes, most observers feel it will be impossible to bring down the deficits. However, it is believed that Bush is ready to call for cuts ("sequestering") in both military and civilian expenses. That's where the fun begins or the game of who cuts where and how. Meanwhile, until Janaury or beyond the budget is in no-man's land.

The military is already conceding that the best they'll get is spending in line with inflation, but most think it will be cuts rather than increases. Here are a few paragraphs from the Nov. 27 *NY Times* article entitled, "The Coming Crunch for the Military Budget: The B2 Stealth bomber, rolled out last week with great ceremony, symbolizes some of the problems. The aircraft with the wings of an albatross and the curves of a manta ray, looked every bit the package of technical nonpareil that the Air Force has promised. It also served as a reminder of the new realities facing the American military.

"At an expected price of $500 milllion each, the Stealth may cost approximately its weight in gold. And Air Force officials acknowledge that they are taking a big gamble on a weapon that three or four years from now might be consuming as much as a third of the Air Force's annual procurement budget. The fanfare over the Stealth contrasted with the troubles of another gamble, the B-1 bomber, which cost $28 billion for 100 planes. Two of the aircraft, which have been plagued by technical problems, crashed this month. . . . The General Accounting Office, in a report last week, said that the Defense Department's current five-year program calls for spending about $200 billion more than the Defense Dept. can expect to receive during that period.

Said former Defense Secretary McNamara, "the new defense secretary will have a job that is 'damn near impossible. You're going to have to cut two airacraft carrier groups and either the B-1 or B-2 bomber. You're going to have to do all kinds of things that are going to be politically unpopular.' "

* *

Speaking of the military, here's an interesting quote from Life magazine from Vernon Walters (US ambassador to the UN): "Yes, war is going out of style. There hasn't been a successful war since we stopped the Communists from overrunning South Korea. Nation's don't go to war just to get a lot of people killed, and the economic cost of war is absolutely incredible. All the hurly-burly on Iran-gate was about $31 million worth of arms that was supposed to have been given the Iranians. That amount would sustain an artillery bombardment for maybe 15 or 20 minutes."

* *

The new Zagat guide picks the best hotels in the US, and here are their choices: (1) Mansion on Turtle Creek in Dallas, (2) Windsor Court in New Orleans, (3) Hotel Bel Air in Beverly Hills, (4) Remington on Post Oak Park, Houston, (5) Ritz-Carlton, Atlanta, (6) Kahala Hilton, Honolulu, (7) Mandarin Oriental, San Fran., (8) Grand Bay Hotel, Miami, (9) Four Seasons, Phila. (10) Ritz-Carlton, Chicago. In NYC they list only two, the Plaza Athenee and the Carlyle. Russell Comments: The Windsor Court in New Orleans is one of the prettiest hotels I've seen -- I'd recommend it to anyone. Here are two other winners not on the list: the Westwood Marquis in Westwood (LA) and the L'Hermitage in Beverly Hills. Both are beautiful hotels with outstanding restaurants. Here's another Russell secret -- best little-known restaurant in NYC is La Tulipe. It's expensive but great.

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Despite the "institutions own everything" misconception, individuals actually own 60% of all common stock in the US. And this excludes their holdings of stocks through mutual funds. However, individuals account for no more than 15% to 20% of daily trading.

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Comptroller General Charles Bowsher notes that the deficit for the fiscal year 1988 which ended in September was reported to be $155 billion. Bowsher said the actual deficit came to $252 billion, but it was camouflaged by the $97 billion in excess tax collections for Social Security benefits and other trust funds (the trust funds are being set aside for the baby-boom generation which will begin retiring in 2010).

* *

Here in San Diego, 25 miles from Mexico, we watch events south of the border carefully. The US is the world's only advanced-capitalist country with a border next to an under-developed Third-World nation. Mexico's population of 80 million includes 36 million under 17 years of age. Unemployment rates in Mexico are worse than America's worst days during the 1930s depression. In the face of this, during the next 10 years Mexico's work force will double. Furthermore, Mexico has an external debt of $102 billion. It's annual interest and debt-reducing payments are a staggering $9 billion. Mexico's austerity program is squeezing a population that is already destitute, except for a tiny minority of extremely wealthy citizens. Mexico's new President Salinas states that he wants immediate negotiations on the "unacceptable and unsustainable" transfer of the country's resources to its creditors.

* *

In a recent Letter I stated that no nation in history has grown rich without wanting a military to protect its riches. Along these Lines, *Reuters* (Nov. 29) announced, "Japan and the US today settled the details of a plan to develop a new jet fighter for Japan's Air Force to be based on the US's F-16 fighter, Defense Agency officials said. General Dynamics will provide the technical information while a consortium of Japanese companies led by Mitsubishi, Japan's biggest aircraft maker, will build the planes." Russell comment: If you're a WW II combat vet like this writer, ya gotta be a bit cynical.

* *

Hollywood Unreal Estate: Eddie Murphy has just purchased Cher's exotic (I've been there) Egyptain-style house -- the asking price was $6.4 million. Burt Reynolds has put up his Holmby Hills house for $6 million. Ray Milland has sold his house with 420 feet of frontage on the Bel Air Country Club golf course for $3.5 million (the house will be torn down). Meanwhile, Zsa Zsa Gabor has upped the price of her Bel-Air home to $15 million (this is the second increase since June when she first put her house up for sale for $6.95 million). What's happening? Wild LA prices plus stars with huge incomes.

* *

Tokyo, the world's safest large city, has muggings at the rate of 40 per 1 million inhabitants. NYC has 11,000 per 1 million inhabitants. Japan's annual robbery rate is 1.8 per 100,000 residents, in the US it's 205.4 per 100, 000.

* *

Shearson has come up with a new "unbundling" scheme for stocks with each share of a company separated into three parts -- a bond, a preferred stock and a certificate that is like a stock purchase warrant. Russell comment: I like to keep it simple, and the three-part concept is anything but simple. In my opinion, the tri-partite stock will confuse the public and turn them off even more on common stocks.

* *

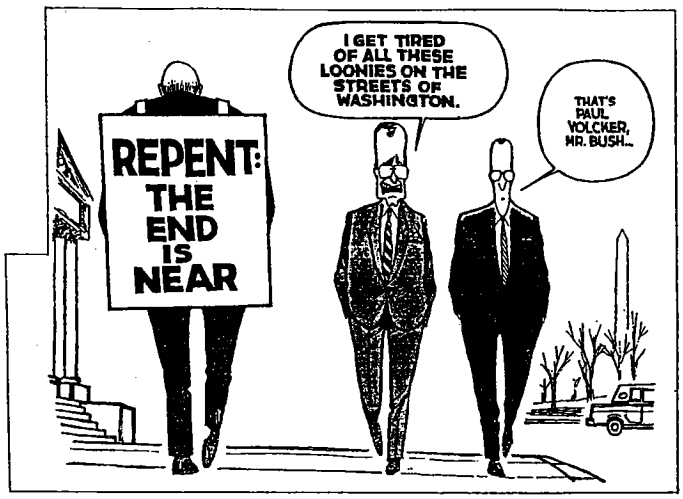
They're starting: Dan Rostenkowski, Chairman of the House Ways and Means Committee, states that if Mr. Bush insists on cutting the tax rate on capital gains, he believes Dems will press for a boost in the top individual tax rate, which is currently 28%.

* *

Want to see where I hang out? The January issue of "Travel and Leisure" magazine will feature an article, "All Over La Jolla."

* *

I got a laugh out of this cartoon by San Diego's Steve Kelley. But on second thought, maybe it isn't so funny.



GOLD: Are you worried about the world producing too much gold? This question has come up before, at which time I asked, "Too much gold compared with what?" The tabulations below should be studied. Note that over the past five years the printing of paper money has outpaced the production of gold on a ratio of better than 10 to one (and this is just paper from 20 nations -- it does not include paper from 130 other nations such as China, Russia, and India). Furthermore, the bulk of newly-produced gold goes into jewelry, so this greatly reduces the amount of "trade-able" or monetary gold available. Therefore, I wouldn't worry too much about rising gold production. It's rising paper production we should be worrying about.

20 Industrialized Countries
New Money Creation *
vs.
New Gold Mined (entire world)
(in billions)

	1983	1984	1985	1986	1987	5 Year Total
New Money*	$200	$154	$202	$290	$295	$1,141
Gold	$ 18	$ 20	$ 21	$ 25	$ 25	$ 109
Ratio	11.1	7.7	9.6	11.6	11.8	10.5

The inflation rate in the US is now about 5%, and studies show that when inflation nears 5% hard assets start out-performing financial assets. Along these lines, here's a chart from Morgan Stanley showing what has happened to various categories of assets over the most recent three months.

How's this for a startling trend change? Neither of last year's Super Bowl teams (Washington and Denver) even made the playoffs this year. This has never happened before in NFL history.

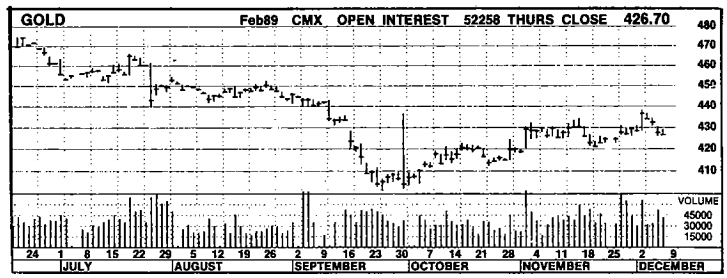
Three Month Rank

Rank	Category	3 Mo %
1	Rare Coins (65CC)	39.1
2	Rare Coins (65A)	30.8
3	Diamonds	23.2
4	Gem Market Index	5.8
5	Junk Bond Funds	2.7
6	Tax-Exempt Funds	2.4
7	Bond Funds	2.3
8	Silver Bullion	2.3
9	GNMA Funds	1.9
10	US Gov't Bond Funds	1.8
11	Money Market Funds	1.6
12	NASDAQ Index	1.5
13	Nikkei Index	1.4
14	Tax-Exempt Money Market Funds	1.1
15	Dow Jones Industrial Average	1.0
16	Consumer Price Index	1.0
17	Utility Funds	0.8
18	S&P 500 Index	0.7
19	Stock Funds	0.2
20	Global Bond Funds	-2.4
21	International Stock Funds	-3.9
22	Gold Funds	-5.6
23	Gold Bullion	-6.1
24	Crude Oil Prices	-13.1

Meanwhile, the gobal debt build-up is assuming unbelievable proportions, with estimates of the total world debt verging on 20 trillion dollars. Obviously, this debt will never be paid off, and, I'm making this statement during semi-boom times. What happens when the inevitable slump arrives? I've said this before, but I'll repeat it. Debt can be extended (re-financed), it can be reneged on, or it can be inflated away. We may see some of each in the years ahead, but the global temptation will be to re-monetize world debt via a major boost in the price of gold.

How would this help? Every nation's reserves consist of gold and foreign currency. If the price of gold were raised, the reserves of all the gold-holding nations would be increased accordingly. This is exactly what could happen if a deflationary or debt-crushing recession materializes. At that time, the temptation to raise the price of gold would be overwhelming (and don't forget, we have the 1934 instance as a precedent).

This chart (courtesy of *Investors Daily*) traces the path of gold over recent months. Here's what I think the chart is telling us. Back in late-September gold (February contract) established a base at 390. Then in October gold established a base at 410. In November the base was moved up to 420. In early December gold ran up to just under 440. The metal is now dropping back (still Feb. contract) perhaps to test the 420 level again. The 420 level should hold, but in any event I would think that gold between 400 and 420 is at attractive, really bargain, levels.



LATE NOTES: Bear markets can be sneaky, and trouble can creep up on you almost without your noticing it. I haven't seen the following rundown anywhere, and it may surprise you, but I suggest you study this list. It's a list of the various major indices and indicators and the dates and values at which they hit their 1988 highs.

Date it topped	Item	Value
January 29	D-J Utility Average	190.02
March 3	D-J 20-Bond Average	91.25
March 17	A-D ratio	-7.72
July 5	Value Line Comp	238.74
July 5	NASDAQ	396.11
July 5	AMEX Average	309.59
Oct 21	S&P 500	283.66
Oct 21	NYSE Composite	159.42
Oct 21	NYSE Financial Av.	136.16
Oct 21	D-J Industrial Av.	2183.50

In a bear market (which this is) I consider any new high in an average or index as having recorded a bear peak -- until proved otherwise. The "otherwise," of course, would be a new high above the previously recorded high. In other words, I am saying to the market, "Go ahead, prove to me that you're going higher by rallying abvove those previous peaks." Now you'll have admit that the list above presents a good many potential bear market peaks. The post-crash correction could be slowly fizzling out.

Subscribers who were with me in 1987 will remember that we used this same technique in that fateful year -- with great success. The success, of course, was that it provided overwhelming evidence that the 1987 market was under heavy distribution. That distribution ended with a bear signal and history's worst crash.

Last week the yield on the two–year T-note rose above the yield on the long bond. Thus, the US is very close to a bearish "inverted yield" (Australia, Britain and Canadian have already gone to inverted yields).

NEXT MAILING: Dec. 28